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DOW THEORY LETTERS, INC.

"The Market as Interpreted under the Dow Theory"

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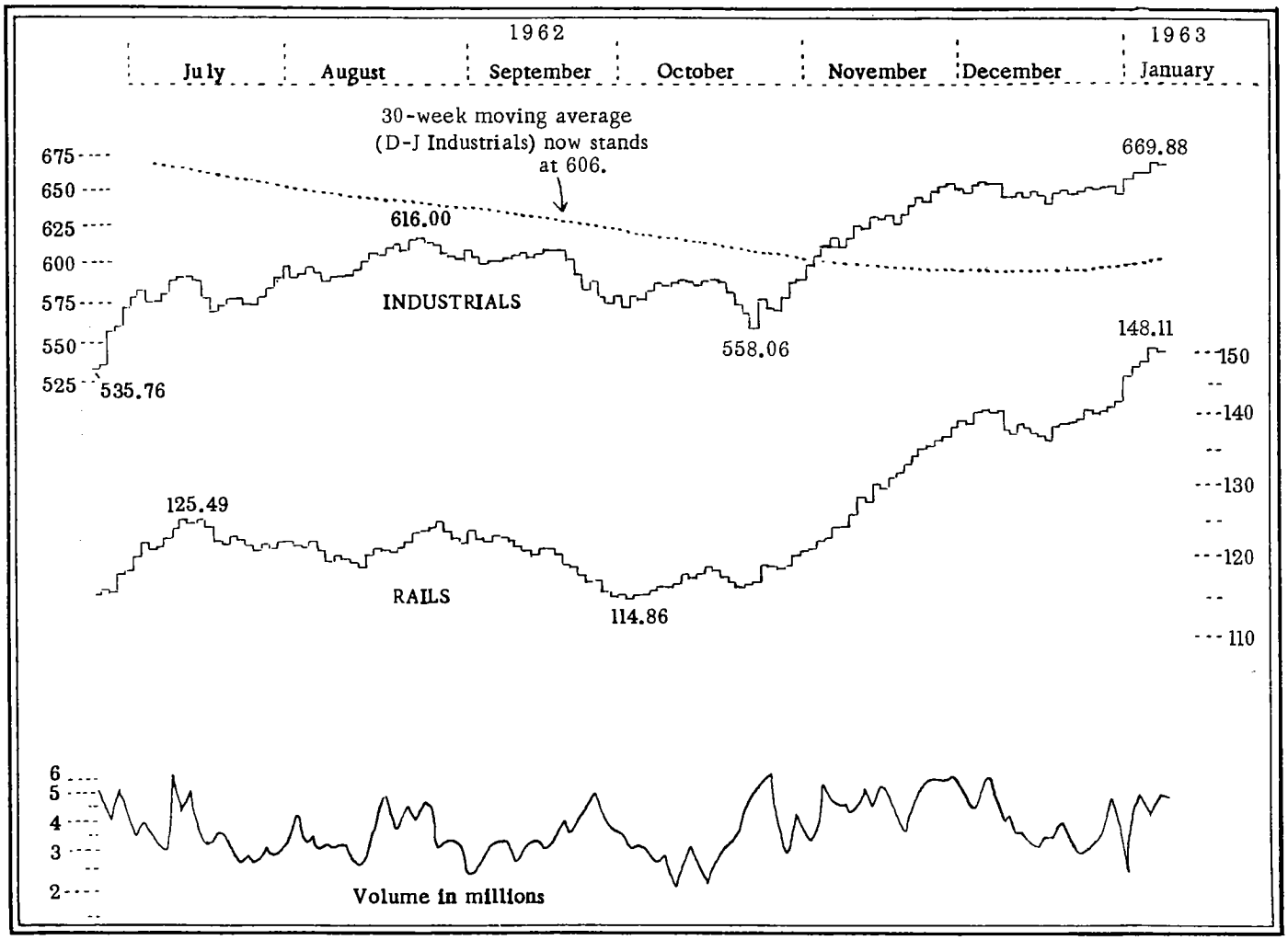
THE MARKET On January 2 Industrials dropped 5.31 points against a rise of .99 in the Rail Average. Volume on that day was extremely low and the advance-decline ratio actually advanced. The suggestion was of an almost complete absence of selling pressure. The next day (January 10) Industrials rose over 10 points on increasing volume, thereby confirming the prior new high on the Rail Average. On January 4 the advance-decline ratio bettered its preceding December 5 peak, and this move put all market indicators "in gear" on the upside to the accompaniment of increasing volume.

As noted in Letter 205, Industrials had fluctuated within a narrow (2%) range for 26 trading days (since November 26). This action plus the relatively narrow fluctuations in the Rail Average suggested the formation of a "line".

Following a rise, a line (in technically strong markets) can take the place of a correction. The bettering of the line limits on January 4 implied that the line formation which has been in existence since late November had taken the place of what might normally have been a correction of the rise.

In terms of percentages, the Rails (see chart) continue to look considerably stronger than Industrials. In fact, since the October lows Rails have gained 30% while Industrials have gained 20%.

CONCLUSION With both Averages in gear and the advance-decline ratio rising to new recovery highs, technical indications point to higher prices.



If there is a hint of danger in the current market, it is (1) in the lack of "values" as indicated by price-earnings ratios and yields, and (2) in the almost unanimous professional opinion that the market is headed higher. Hamilton stated on a number of occasions that he had "...never known the majority of professional opinion to be correct."

COMMENTS: Explosive (almost vertical) rises of the type seen since last October are not usually associated with extended (in duration) movements or for that matter with bull markets. Such movements in the past have generally ended with long, sideways formations or abrupt reversals. Since 1920 there have been eleven Industrial rises of 16% or more occurring within a period of eight weeks or less. Two of these advances (July-August, 1932 and April, 1933) came within a major bull market. The rest were either bear market reactions or final bull market "blow-offs." It is interesting to note that on all occasions but 1928 the rises were preceded by important declines. The record is as follows:

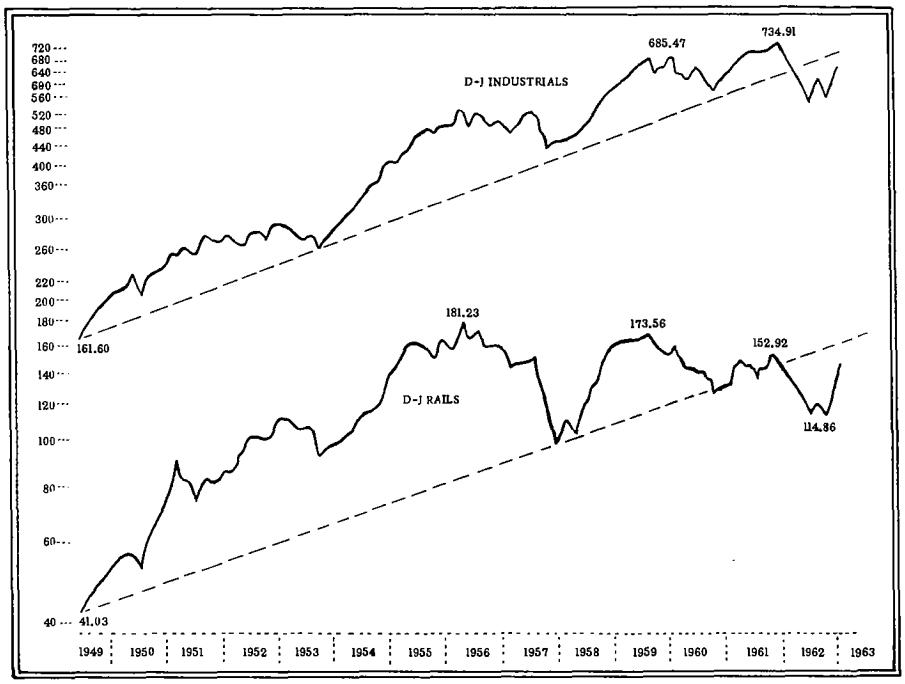
YEAR		AMOUNT OF RISE	COMMENT
Feb., March	1920	16%	reached new lows in May
November	1928	18%	declined to starting point in December
June	1929	17%	reached new lows in November
Nov., Dec.	1929	40%	rise continued till April
February	1931	22%	reached new lows by April
June	1931	33%	reached new lows by Spetember
July, August	1932	175%	beginning of new bull market
April	1933	33%	rise continued until July
June, July	1938	32%	rise continued until November
October	1938	19%	reached new lows in April, 1939
September	1939	22%	reached new lows in May, 1940

FOURTEEN YEARS Periodically, I find it of value to review the price movement from the standpoint of years, rather than months or weeks. The "big picture" was last reviewed in Letter 191. At that time, attention was directed to the long-term trendlines in the Averages (trends which began in 1949). It was stated that on semi-logarithmic charts, as long as the rate of upward thrust (growth or inflation factor) continued at the same rate, the Averages would continue to hold above their long-term trendlines.

As seen on the accompanying chart, the rate of advance continued in both Averages from June, 1949, until October, 1960. At the latter date, Rails broke slightly below their long-term trendline. However, the violent 1961 rise served to return Rails above the trendline again. It is of interest that Industrials acted considerably stronger than Rails during 1960, and at that time the senior Average refused by a considerable margin to violate its own trendline.

The 1962 collapse did a great deal more damage (from a trend standpoint) than any decline since 1949. In mid-1962, both Averages dropped decisively below their fourteen year trendlines; moreover, the 1962 decline took both Averages well below the major lows which had been established two years earlier (in October, 1960).

Many readers are probably not aware that the bull market high in Rails was struck on May 9, 1956 at 181.23. A post-1956 low was recorded by Rails in December, 1957 at 95.98. During the five years since December, 1957, Rails have fluctuated entirely within their 1956-57 range. Whereas Industrials have outperformed Rails almost continously since 1956 (see chart), it is perhaps understandable that Rails should outperform Industrials on the recovery from the 1962 lows. The highest point reached by the carriers since their bull market (1956) high was 173.56 in July, 1959. The last important Rail peak was the 152.92 high of 1961. As of this writing, Rails are within striking distance of the '61 high.



Following periods of severe downward compression, it is not unusual to see the Averages (and this is also true of individual stocks) rise to or just below the ascending trendline which was violated. It is possible that we are witnessing such a phenomenon at this time.

The accompanying chart will allow subscribers to put the 1962 decline and subsequent recovery within the proper perspective. As seen on the chart, each of the rises since 1949 (i.e., 1949-53, 1954-56, 1957-59, 1960-61) has been shorter (in duration) but steeper than the last. Each has been accompanied by less and less "breadth". It remains to be seen whether this sequence will be broken during 1963.

LOW-PRICED STOCKS Many of the quickest and most spectacular profits are made in low-priced stocks, but correct timing in the purchase of these issues is always critical. The great moves in the speculative issues (the "cats-and-dogs") usually take place during the third or final phase of a bull market. The accompanying chart traces the explosive rise in Barron's Low-Priced Stock Index from its 1957 low of 114 (approximately the beginning of the third phase of the bull market) to its 1959 peak of 250.

Historically, once the L-P Index hits its final bull market peak, it falls rapidly, never to rise to new highs again (during the life of the bull market). This "topping out" of the low-priced stocks always comes before the final top in the D-J Industrial Average.

True to form, Barron's L-P Stock Index topped out in March, 1959 (ten months before the Industrial Average struck an all-time high). From its 1959 high of 250 the L-P Index dropped to a 1960 low of 162.

Then the unexpected (and unorthodox) occurred. A second rise (1960-61) took the Industrial Average to another all-time peak of 734.91 in December, 1961. Although the L-P Index rose sharply during the second rise, it failed by 10 points (see chart) to better its 1959 high. The inability of the L-P Index to rise to new highs proved an early warning.

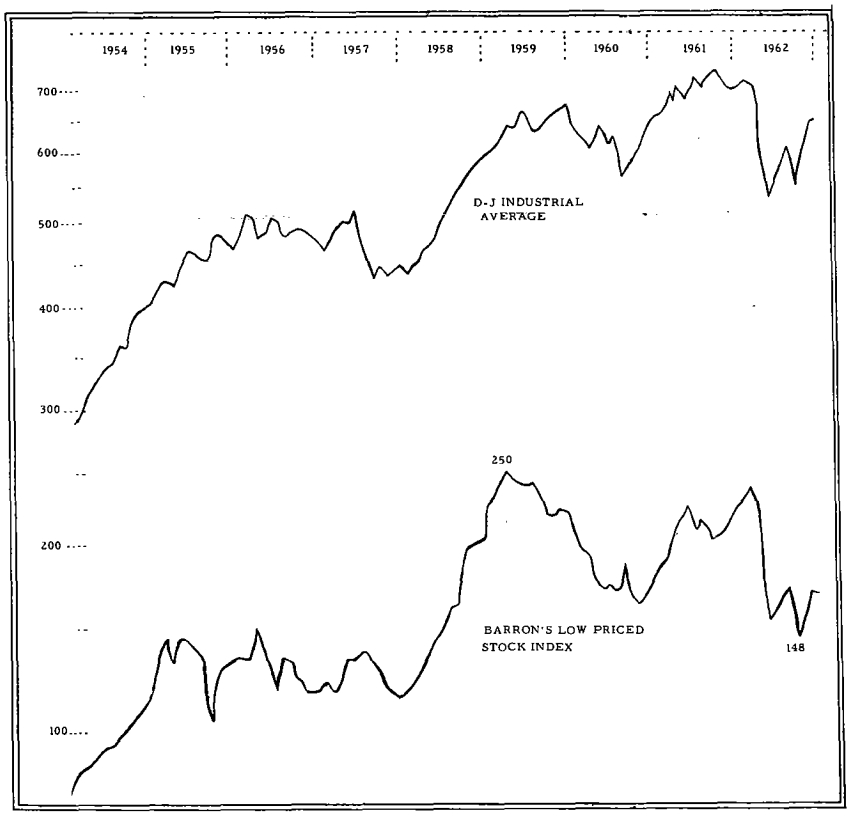
The market collapsed in the first half of 1962. During that time the L-P Index fell to a four-year low of 148 (October, 1962).

Note that the Industrial Average has never risen substantially above its 1959 peak (685.47), the peak which was established after the initial collapse of the L-P Stock Index in 1959. For this reason, it occurs to me that future market historians may label the entire period from 1959 to the present as part of a massive and extended market "top."

Note also that the 1957-59 Industrial rise was accompanied by a true bull market "blow off" in the L-P stocks. The short lived 1960-61 rise was accompanied by a much less impressive rise in L-P stocks. The rise from the 1962 lows has (so far) exerted remarkably little upside pressure on the "cats-and-dogs."

Nevertheless, over the past month there have been signs of stirring in the speculative sector of the market, and during the past week there has even been a suggestion of upside activity on the American Exchange.

My own studies suggest that once the speculative "back" of the bull market is broken, the speculative force never fully recovers. If some of 1962's "collapses" were to correct even part of their losses, however, the moves could be profitable. Letter 203 listed 10 investment-grade issues and 13 speculative issues which (1) were at or near their "crash-lows", (2) would show substantial profits if they regained as little as a third to a half of their bear market losses, (3) were a reasonable hedge against a further market advance. Comments on additional individual stocks follow:



STOCKS Of 350 stocks which are tabulated at this office, 289 (83%) are now above their own 30-week moving average.

This is a sharp rise of 20% since the last Letter. Of the same stocks, only 42% are above their August (1962) recovery highs, and this is a rise of 4% since the last Letter.

The latter figure is particularly significant, since it means that following the initial market rise (June to August, 1962), the majority of stocks have not "moved out" or risen above their first rally peak.

The bettering of the August peak has been the signal for most of the best recent rises. For those who wish to speculate on individual upside moves from here, I have listed the following stocks as looking best for potential moves IF they can better their preceding peaks. Numbers in parentheses indicate "breakout points" or points at which each stock will have cleared its August high (at which time it may be labeled a speculative purchase).

Allis Chalmers (17), American Airlines (19 1/2), Automatic Canteen (18 1/2), Ferro Corp. (40), Gen. Precision Equipment (40), Kaiser Aluminum (signals given at 37), Mergenthaler Linotype (26), National Lead (74), Reynolds Tobacco (45), Spiegel (30), U. S. Rubber (45).

I include three weekly charts below. J. I. Case dropped from a high of 25 1/2 in 1959 to a low of 4 1/2 in 1962. The stock has formed one of the few ascending triangles on the Board and has more recently broken its downward trendlines. Given a firm market, Case should be a good speculation at this time. Kaiser Aluminum, down from a bull market high of 70 in 1956, has broken out of a large symmetrical triangle. As such, the stock should now be labeled "bullish." Spiegel dropped from a 1961 high of 64 to a 1962 low of 20 1/4. Spiegel has reversed its long downtrend, and it has formed a large symmetrical triangle. The breakout would come at 29 1/2, at which point Spiegel would be a good speculation.

LATE NOTES (Written Thursday, January 10, 1 P.M., N.Y. time) The most recent recovery highs were set on January 8, at 669.88 for Industrials, 150.52 for Rails. A one-day decline set in on January 9 and today the Averages are rallying again. As of this writing, Industrials have (on an inter-day basis) bettered their 669.88 peak, but Rails have not. With the January 8 recovery highs of 669.88 and 150.52 in mind, readers should remember that a new high on one Average unconfirmed by a comparable high on the other is meaningless (and at times can constitute a danger signal).

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Charts on this page courtesy of Traders Research, P.O. Box 2466, St. Louis 16, Missouri.